

**IT 06-1**

**Tax Type: Income Tax**

**Issue: Responsible Corporate Officer – Failure to File or Pay Tax**

**STATE OF ILLINOIS  
DEPARTMENT OF REVENUE  
OFFICE OF ADMINISTRATIVE HEARINGS  
CHICAGO, ILLINOIS**

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**THE DEPARTMENT OF REVENUE  
OF THE STATE OF ILLINOIS**

**v.**

**JOHN DOE,  
As Responsible Officer of  
ABC, Inc.,  
Taxpayer**

**No. 04-IT-0000  
FEIN: 00-0000000  
SSN: 000-00-0000  
NOD: 0000**

**Kenneth J. Galvin  
Administrative Law Judge**

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**RECOMMENDATION FOR DISPOSITION**

**Appearances:** Mr. Edward X. Clinton, on behalf of John Doe, Ms. Shiel Gupta, Special Assistant Attorney General, on behalf of the Department of Revenue of the State of Illinois.

**Synopsis:**

This matter comes on for hearing pursuant to John Doe's protest of Notice of Deficiency No. 0000 (hereinafter "NOD"), as responsible officer of ABC, Inc. (hereinafter "ABC"). The NOD was issued for unpaid Illinois withholding tax and covers the third and fourth quarters of 2002 and the first and second quarters of 2003. A hearing was held in this matter on August 4, 2005, with Mr. Doe and Joe Blow, a carpenter for ABC, providing oral testimony. Following submission of all evidence and a review of the record, it is recommended that NOD No. 0000

issued against Mr. Doe be finalized as issued. In support thereof, the following “Findings of Fact” and “Conclusions of Law” are made.

**Findings of Fact:**

1. The Department’s *prima facie* case, inclusive of all jurisdictional elements, is established by the admission into evidence of NOD No. 0000, dated April 20, 2004, issued against John Doe, showing a withholding tax liability for ABC, Inc. in the amount of \$15,578.20 for the third and fourth quarters of 2002 and the first and second quarters of 2003. Tr. pp. 9, 59-60; Dept. Ex. No. 1.
2. Mr. Doe’s protest dated May 5, 2004 states that “[O]n August 22, 2003, I tendered my resignation as an officer and employee of ABC, Inc.” Tr. p. 9; Dept. Ex. No. 2.
3. ABC’s “State of Illinois Domestic Corporation Annual Report” for year 2002 shows “John Smith” as “President” and “Director” and “Jon Doe” as “Secretary” and “Director.” Mr. Doe was 50% owner of ABC. John Smith was married to Mr. Doe’s wife’s sister. Tr. pp. 10, 14, 16, 19, 56-57; Dept. Ex. No. 3.
4. Mr. Doe was able to and did write checks on ABC’s checking account. Mr. Doe kept a packet of checks with him and there was no dollar limit on the checks that he could write. Mr. Doe was a signatory throughout his tenure at ABC. Tr. pp. 21-22, 70-73.
5. In a letter dated September 4, 2003, James D. Skaar, Attorney for Mr. Doe, wrote to Michael J. Morrisroe, Attorney for ABC, requesting financial information on ABC. The letter states that “[T]he proposal in the Stock Purchase Agreement is that Jon Doe transfer all of his stock in the corporation to John Smith for no consideration other than an indemnification against corporate liabilities.” Financial information, including monthly income and expense statements, balance

sheets, a current list of accounts receivable, and copies of all federal tax returns, was requested.

Tr. pp. 25-28; Taxpayer's Ex. No. 1.

6. In a letter dated September 25, 2003, Mr. Morrisroe responded to Mr. Skaar enclosing a copy of the 2001 Income Tax Return for ABC and detailing approximately \$210,000 in outstanding liabilities for ABC including \$90,000 for "payroll liabilities." Tr. pp. 29-34; Taxpayer's Ex. No. 2.
7. In a letter dated October 9, 2003, Mr. Morrisroe wrote to Mr. Skaar stating "[E]nclosed please find copies of the following documents relative to ABC, Inc. " Check registers for 2002 and 2003, Profit and Loss for 2003, including previous year comparison, detailed balance sheet for 2003, income and expense graph for 2003, and payroll summary for 2003. Tr. pp. 34-35; Taxpayer's Ex. No. 3.
8. ABC's Balance Sheet dated October 9, 2003 shows "Payroll Liabilities-State Withholding" of \$15,081.76. Tr. pp. 35-36; Taxpayer's Ex. No. 4.
9. ABC's Income Statement for the period January 1 through October 9, 2003 as compared to the same period for 2002 shows a \$33,112 net loss for 2003 and a \$73,812 net loss for 2002. Tr. pp. 37-40; Taxpayer's Ex. No. 5.
10. In a "Stock Purchase Agreement" dated August 22, 2003, Mr. Doe agreed to sell his 500 shares of ABC to Mr. Smith (Purchaser). Paragraph 4.2 of the Agreement states that "Purchaser agrees that he shall indemnify and hold the Seller harmless for any loss or liability of ABC before or after the closing date." "In addition, Purchaser agrees to indemnify Seller from any and all claims from the ... Illinois Department of Revenue." Page 9 of the Agreement contains Mr. Doe's resignation "effective August 22, 2003" "as officer and employee of ABC, Inc." Tr. pp. 41-46; Taxpayer's Ex. No. 7.

### **Conclusions of Law:**

The sole issue to be decided in this case is whether John Doe should be held personally liable for the unpaid withholding tax of ABC, Inc. The personal liability penalty is imposed by Section 3-7 of the Uniform Penalty and Interest Act, which provides as follows:

Any officer or employee of any taxpayer subject to the provisions of a tax Act administered by the Department who has the control, supervision or responsibility of filing returns and making payment of the amount of any trust tax imposed in accordance with that Act and who willfully fails to file the return or to make the payment to the Department or willfully attempts in any other manner to evade or defeat the tax shall be personally liable for a penalty equal to the total amount of tax unpaid by the taxpayer including interest and penalties thereon. The Department shall determine a penalty due under this Section according to its best judgment and information, and that determination shall be *prima facie* correct and shall be *prima facie* evidence of a penalty due under this Section.  
35 ILCS 735/3-7.

It is clear under the statute that personal liability will be imposed only upon a person who: (1) is responsible for filing corporate tax returns and/or making the tax payments; and (2) “willfully” fails to file returns or make payments.

The admission into evidence of the NOD establishes the Department’s *prima facie* case with regard to both the fact that Mr. Doe was a “responsible” officer and the fact that he “willfully” failed to file and or pay. Branson v. Department of Revenue, 168 Ill. 2d 247, 262 (1995). Once the Department has established a *prima facie* case, the burden shifts to the taxpayer to overcome the case. Masini v. Department of Revenue, 60 Ill. App. 3d 11 (1<sup>st</sup> Dist. 1978).

In determining whether an individual is a responsible person, the courts have indicated that the focus should be on whether that person has significant control over the business affairs of a corporation and whether he or she participates in decisions regarding the payment of creditors and disbursement of funds. Monday v. United States, 421 F. 2d 1210 (7<sup>th</sup> Cir. 1970), *cert. denied*, 400 U.S. 821 (1970). Liability attaches to those with the power and responsibility within the corporate structure for seeing that the taxes are remitted to the government. *Id.*

I conclude, based on the testimony and evidence admitted at the evidentiary hearing, that Mr. Doe was a responsible party under the statute. ABC's "State of Illinois Domestic Corporation Annual Report" for year 2002 shows "Jon Doe" as "Secretary" and Director." Mr. Doe was 50% owner of ABC and he retained that ownership throughout the existence of ABC. Tr. pp. 10, 14, 16, 19, 56-57, 67-68; Dept. Ex. No. 3. Mr. Doe testified that he thought he was Vice-President of ABC. Tr. pp. 19, 62-63. The Notice of Deficiency at issue in this case covers the third quarter of 2002 through the second quarter of 2003, ending June 30, 2003. In Mr. Doe's protest dated May 5, 2004, he stated that "[O]n August 22, 2003, I tendered my resignation as an officer and employee of ABC, Inc." Tr. p. 9; Dept. Ex. No. 2. By Mr. Doe's own admission, he retained his corporate positions with ABC throughout the entire period covered by the NOD.

Mr. Doe testified that he did not have an employment agreement with ABC. Tr. p. 67. According to Mr. Doe, the duties of Mr. Smith and Mr. Doe were not memorialized in any document. Mr. Doe, who is a carpenter by trade, testified that Mr. Smith would set up the books for ABC and "run the office work" and Mr. Doe would see "that the work in the field got done." Tr. pp. 14-15. According to Mr. Doe, Mr. Smith was "in charge of running the financial and office work." Tr. p. 17. Mr. Doe testified that he had not spoken to Mr. Smith since August 22, 2003, although he has made attempts to contact him by phone, by letter and by sending messages through

his wife. Tr. p. 49. Mr. Smith was not called to testify at the evidentiary hearing and I am not aware of a subpoena being issued for his appearance at the hearing. Apparently, Mr. Doe chose not to subpoena the one person who could corroborate his testimony that he worked in the field but not in the office. Even if Mr. Doe was not involved in ABC's financial and office work, this was his choice. As a 50% shareholder and owner, holding the offices of Director, Secretary and/or Vice-President, he could have inspected ABC's corporate books at any time and become directly and personally involved in the office work, if he desired. Mr. Doe was asked if he had any reason to believe that [he] would not have access to financial statements that were kept in the office of ABC. He responded "[N]o." Tr. p. 79.

Mr. Doe testified that he had check writing authority. Mr. Doe was able to and did write checks on ABC's checking account. Mr. Doe kept a packet of checks with him and there was no dollar limit on the checks that he could write. Mr. Doe was a signatory throughout his tenure at ABC. Tr. pp. 21-22, 70-73. Mr. Blow, also a carpenter for ABC, testified that if Mr. Smith didn't bring Mr. Blow's payroll check to the jobsite, Mr. Doe "carried a checkbook with him and he could just write a check out of that checkbook." Tr. p. 124. According to Mr. Doe, he wrote checks for "incidental materials, supplies, tools." Tr. p. 70. He testified that Mr. Smith "wrote all the large checks," with "large" being over \$1,000. Mr. Doe did not recall if he personally wrote checks for more than \$1,000. Tr. p. 22.

In a letter dated October 9, 2003, Mr. Morrisroe, Attorney for ABC, wrote to Mr. Skaar, Attorney for Mr. Doe, stating "[E]nclosed please find copies of the following documents relative to ABC, Inc: Check registers for 2002 and 2003..." Tr. pp. 34-35; Taxpayer's Ex. No. 3. No check registers for 2002 and 2003 were admitted into evidence and no explanation was offered for their absence. No bank signatory cards or check approval authorizations were admitted into evidence for

any quarter included in the NOD. Since ABC's check registers for 2002 and 2003 are apparently in Mr. Doe's possession, and he did not offer them as evidence at the hearing, I must conclude that his testimony that he wrote small checks only for supplies is not credible. Without the check registers, bank signatory cards, or check approval authorizations, I am unable to verify that Mr. Smith ever signed a check or even had authority to sign a check.

The ability to sign corporate checks is a significant factor in determining whether a person is a responsible party because it generally comes with the ability to choose which creditors are paid. Gold v. United States, 506 F. Supp. 473, (E.D.N.Y. 1981), aff'd, 671 F. 2d 492 (2d Cir. 1982). At any time during the period at issue covered by the NOD, Mr. Doe could have written a check to the Illinois Department of Revenue to cover the unpaid withholding taxes. If Mr. Smith could also have written a check to the Department, this does not relieve Mr. Doe of responsibility. In any corporation, there may be more than one responsible officer. Monday v. United States, *supra*. The statute does not confine liability to only one person in the corporation or to the person most responsible. 35 ILCS 735/3-7. If Mr. Doe wrote checks for incidental materials, supplies and tools, and did not write checks for payroll deposits, he was in fact participating in decisions regarding the payment of creditors and disbursement of funds, signifying further that he was a responsible officer of ABC.

Mr. Doe's testimony about his total lack of involvement with ABC's "financial and office work" is self-serving, not backed up by any documentary evidence and in some cases, contradicted by Mr. Blow, who also worked as a carpenter for ABC. Mr. Doe admitted that he had employees who reported to him and that he hired and fired employees. Tr. p. 17. But according to Mr. Doe, Bob Smith "made up the paychecks." Tr. p. 20. A "payroll summary for 2003" and ABC's check registers for 2002 and 2003 were turned over to Mr. Doe in a letter dated October 9, 2003.

Taxpayer's Ex. No. 3. The payroll summary and the check registers were not offered into evidence and I am unable to verify that Mr. Doe did not sign ABC's payroll checks. Additionally, Mr. Doe testified that he never signed tax returns. Tr. p. 23. The 2001 Income Tax Return for ABC was turned over to Mr. Doe in a letter dated September 25, 2003. Taxpayer's Ex. No. 2. No income tax returns for ABC were admitted into evidence and I am unable to verify that Mr. Doe did not sign ABC's tax returns.

Mr. Doe's "Stock Purchase Agreement" is "dated as of August 22, 2003," and Mr. Doe's resignation attached to the Agreement is dated August 22, 2003, effective August 22, 2003. Taxpayer's Ex. No. 7. However, a letter from Mr. Skaar, Mr. Doe's attorney, to Mr. Morrisroe, ABC's attorney, dated September 4, 2003, two weeks after the date of the Stock Purchase Agreement, states that Mr. Skaar is representing Jon Doe concerning the **draft** Stock Purchase Agreement (emphasis added). When Mr. Doe was asked about this discrepancy, he responded: "I probably signed the [Stock Purchase Agreement] at home, you know before, I spoke with Mr. Skaar, and I just wanted him to approve it. I just don't recall." Tr. p. 105. Mr. Doe testified that he visited ABC's office, located in Mr. Smith's basement "once in a while," "once a month, once every other month." Tr. p. 73. Mr. Blow testified that Mr. Doe went to the office "on a weekly basis to pick up payroll things." "I assumed that it was at least once a week because at one period of time Jon was delivering the checks, so he had to pick them up to bring them to everybody." Tr. pp. 125-126.

Mr. Doe's testimony that he visited ABC's office "once in a while" is obviously designed to show his lack of involvement with the financial affairs of ABC. This testimony was effectively contradicted by Mr. Blow. Documentary evidence, apparently in Mr. Doe's possession, which would have supported his testimony was not offered as evidence. There is a discrepancy in the



dates on important documents which Mr. Doe was unable to clarify. The testimony and evidence admitted at the evidentiary hearing, and the documents in Mr. Doe's possession which were not admitted into evidence, force me to conclude that he had significant control over the financial affairs of ABC during the period covered by the NOD, and that by signing checks, he participated in the payment of creditors and disbursal of funds. Accordingly, Mr. Doe has failed to rebut the Department's *prima facie* case, that he was a responsible person under the statute.

The second element which must be met in order to impose personal liability is the willful failure to pay taxes. The Department presents a *prima facie* case for willfulness with the introduction of the NOD into evidence. Branson, *supra*. The burden then is on the responsible parties to rebut the presumption of willfulness.

"Willfulness" as used in the statute may indicate a reckless disregard for obvious or known risks. Monday v. United States, 421 F. 2d 1210 (7<sup>th</sup> Cir. 1970), *cert denied*, 400 U.S. 821 (1970). Willfulness also includes "failure to investigate or to correct mismanagement after having notice that withholding taxes have not been remitted to the Government." Peterson v. United States, 758 F. Supp. 1209 (N.D. Ill. 1990). A person acts willfully in failing to pay delinquent taxes if he prefers other creditors to the State. Department of Revenue v. Heartland Investments, 106 Ill. 2d 19 (1985).

Mr. Doe's conduct was willful under each of the above. ABC's Income Statement for the period January 1 through October 9, 2002 shows a net loss of \$73,812. Taxpayer's Ex. No. 5. It is inconceivable that Mr. Doe was not aware of ABC's financial condition. Mr. Doe was asked on cross-examination whether he was aware "of any times when the corporation was having cash flow problems?" He responded: "Yes. I believe a couple of times [Mr. Smith] told me don't buy any materials until I get this check deposited, things like that." Tr. p. 80. Mr. Doe testified that there

were times that he did not receive a paycheck. “[Mr. Smith] would just say, there’s no money left for us until we get this next draw or next payment.” Tr. p. 81. When Mr. Doe did not get a paycheck, he assumed that Mr. Smith was also not getting a paycheck:

Q. Would there be any way for you to check if he was taking a paycheck and just not giving you one?

A. I guess I could have checked, yes.

Q. And how would you have checked?

A. Well, just asked him.

Q. Is that the only way you would have verified?

A. Without being in the office yes.

Tr. pp. 81-82.

Later in cross-examination, Mr. Doe admitted that he could have gone to the bank to verify whether Mr. Smith was getting a paycheck:

Q. And the bank, did you have any reason to think the bank would not give you that information?

A. No.

Q. Because you were a signatory on the account, correct?

A. Correct.

Q. And you were 50% owner of the company?

A. Correct.

Tr. pp. 83-84.

Mr. Doe testified that he never asked either Mr. Smith or ABC’s accountant whether ABC’s other bills, beside paychecks, were being paid. Tr. p. 97.

Mr. Blow testified that he knew that “there were occasions where several employees were getting their check returned.” “It happened on several occasions... but we were always paid eventually.” Tr. p. 117. According to Mr. Blow, the checks bounced three or four times during 2002. “When we got into the end of 2002, 2003, it was for one period of time, three to four weeks in a row.” Tr. p. 129. It must be noted here that the NOD covered the last two quarters of 2002 and the first two quarters of 2003. Mr. Blow testified that the first few times the checks would bounce, the employees would ask Mr. Doe about it. Tr. p. 129.

Mr. Doe's testified that he was aware of " a couple of times" that ABC was having cash flow problems. Tr. p. 80. He was told not to buy materials until checks were deposited. At times, he did not get a paycheck and assumed that Mr. Smith was not getting a paycheck. Mr. Blow testified that several employees were getting their checks returned and the employees would ask Mr. Doe about it. Each one of these occurrences should have been an indication to Mr. Doe that inquiry into ABC's financial condition was warranted and necessary. By doing nothing, by not asking Mr. Smith about ABC's financial condition, by not going to the bank where he had access to ABC's records, Mr. Doe demonstrated a reckless disregard for obvious or known risks, indicating "willfulness" under the statute. Monday, *supra*.

According to Mr. Blow, at the end of 2002 and beginning of 2003, checks were bouncing three or four weeks in a row. Employees would ask Mr. Doe about the checks bouncing. Tr. p. 129. This was the time period covered by the NOD. Mr. Doe was a signatory on ABC's bank accounts at that time. Tr. pp. 72-73. At the end of 2002, and the beginning of 2003, Mr. Doe could have written a check to the State for withholding taxes. No testimony or evidence was presented to show any steps taken by Mr. Doe to ensure that the withholding taxes were paid to the State. No evidence was presented at the hearing to show what steps Mr. Doe took to correct ABC's mismanagement. By doing nothing, Mr. Doe failed to correct ABC's mismanagement after being on notice that withholding taxes may not have been remitted to the Government, further indicating "willfulness" under the statute. Peterson, *supra*.

Furthermore, no evidence was presented to show that Mr. Doe stopped writing checks to suppliers at the end of 2002 and the beginning of 2003 while he was aware that payroll checks were bouncing. In continuing to pay suppliers while not writing a check to the State for the withholding taxes, which, as a signatory, Mr. Doe could have done, he preferred other creditors to the State,

which is further evidence of “willfulness” under the statute. Heartland, *supra*. Accordingly, Mr. Doe has failed to rebut the Department’s presumption of willfulness.

WHEREFORE, for the reasons stated above, it is my recommendation that Notice of Deficiency No. 0000 be finalized as issued.

January 9, 2006

Kenneth J. Galvin  
Administrative Law Judge